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29 July 1983

MEMORANDUM FOR: Richard J. Kerr
Associate Deputy Director for Intelligence

FROM : Henry S. Rowen, Chairman/NIC

SUBJECT : "Soviet Defense Spending: Recent Trends and Future
Prospects" - An Intelligence Assessment

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1. I am puzzled by the logic in this paper. As I understand it, essentially what we observe is the output of the Soviet production system: ships, missiles, aircraft, electronics, etc. The report shows that there was a decline on leveling off in the weapons output between 1976 and 1981. No problem so far. It also asserts that "procurement expenditures" in rubles were also about level from 1976-81:

2. Here there is a problem: A reduced output of weapons does not necessarily mean that there was a reduced input of resources. The latter might have continued to grow at the pre-1976 rate, or leveled off, or fallen. The data presented are consistent with any of these three possibilities.

3. The big question, which is not stated clearly in the paper, is whether or not planned inputs to the defense production sector were diverted to other sectors (i.e., consumption or civilian investment) during this period? The possibility of such a policy change is discussed. If that happened, would the result be consistent with the main conclusion of the paper that there was almost no growth in procurement expenditures in 1976-81?

4. The other principal explanations offered, manufacturing constraints and industrial bottlenecks, would not necessarily have produced much if any reduction in ruble costs or growth in these costs. If manpower, most material, and industrial plant inputs continue to flow to the military

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production sector, ruble costs would have continued to grow. This phenomenon is, after all, not unknown in the US military industrial sector and it is even easier to believe that it could occur in the Soviet one. If this happened, unit ruble costs escalated sharply during this period.

5. In short, the data presented are consistent with a continuation of the growth of ruble procurement expenditures at 3-4 percent annually. More likely, I suppose, is that a combination of the factors mentioned in the paper resulted in some diversion of planned resources from defense to non-defense uses during this period. But the paper is lamentably unclear on the distinction between inputs--the real ruble resource costs--and outputs--which we observe and use as the basis for our cost estimating.

Henry S. Rowen

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